

[Senate Bill 640](#) (Beall)

Date: 08/18/15

Program: Sales and Use Tax

Sponsor: RYAN Tax Services

Revenue and Taxation Code Section 6901

Effective: January 1, 2016

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**Summary:** Authorizes a customer to file a claim for refund of excess tax reimbursement in the amount of \$1,000 or greater so that the Board of Equalization (BOE) may make a direct refund to the customer.

**Summary of Amendments:** Since the previous analysis, the bill was amended to eliminate the requirement that a retailer make an irrevocable assignment of the right to file a refund and allow customers to file a refund claim directly with the BOE.

**Purpose:** To allow direct reimbursement to a customer who was overcharged sales tax reimbursement. According to the author's office, "Vendor assignment would shorten the refund process by approximately two to three months and eliminate processing by the retailer as the middleman. This bill will enable customers to receive refunds in a more expeditious fashion and ease the workload of certain retailers who will no longer be required to issue refund checks themselves, nor file a claim for refund on the customer's behalf."

**Fiscal Impact Summary:** Indeterminable. To the extent that additional claims would be filed, this could result in a substantial state and local revenue loss. Administrative costs are in excess of \$5 million.

**Existing Law:** Except where the law provides a specific exemption or exclusion, California's Sales and Use Tax Law<sup>1</sup> imposes the sales tax on all retailers for the privilege of selling tangible personal property at retail in this state. The retailer may collect reimbursement from its customer if the contract of sale so provides.<sup>2</sup> California law also imposes the use tax on the storage, use or other consumption in the state of tangible personal property purchased from any retailer.

Under existing Revenue and Taxation Code (RTC) Section 6901.5, when a retailer collects more sales tax reimbursement than is due from a customer, that excess tax reimbursement must either be returned to the customer or paid to the state.

RTC Section 6901 provides that, if the BOE determines that the retailer has paid any amount of sales tax more than once or has erroneously or illegally collected or computed the sales tax, the BOE must note the amount in its records, credit the amount to the retailer's other BOE liabilities, and refund the balance to the retailer, or to the retailer's successor, administrator, or executor. To obtain a sales tax refund, the retailer must submit a claim for refund to the BOE. Section 6901 further provides that the BOE shall refund any overpayment of use tax directly to the purchaser, even though the retailer collected and remitted the tax. In sum, while the statute allows the BOE to refund excess use tax directly to the purchaser, the BOE may issue a refund for excess sales tax reimbursement only to the retailer.

Under subdivision (b)(2) of the BOE's Sales and Use Tax Regulation 1700, *Reimbursement for Sales Tax*, which interprets Section 6901.5, whenever the BOE ascertains that a retailer has collected excess tax reimbursement, the retailer will be afforded an opportunity to refund the excess tax reimbursement to the customers from whom it was collected.

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<sup>1</sup> Part 1, Division 2 of the Revenue and Taxation Code (RTC) (commencing with Section 6001).

<sup>2</sup> Civil Code Section 1656.1. California Code of Regulations, title 18, Regulation 1700.

Regulation 1700(b)(3) provides that the BOE may refund to the retailer excess sales tax reimbursement upon submission of sufficient evidence that the excess tax reimbursement has been or will be returned to the customer. If a retailer has not refunded excess tax reimbursement to the customer, but would rather do so than incur an obligation to the state, the retailer must: (1) inform the customer in writing that excess tax reimbursement was collected and that the excess amount will be refunded or credited to the customer; and (2) obtain and retain for verification by the BOE an acknowledgement from the customer that the customer has received notice of the amount of indebtedness of the retailer to the customer. The BOE's form BOE-52-L2, *Notice of Pending Refund of Excess Sales Tax Reimbursement*, is available to assist the retailer in informing and obtaining an acknowledgment from the customer of the pending refund.

**Proposed Law:** Under specified circumstances, this bill allows the BOE to refund excess sales tax reimbursement to the customer who was overcharged the sales tax reimbursement. The BOE's direct refund to a customer would only be allowed for refunds of \$1,000 or more from a single retailer to a single customer.

The bill requires the retailer to make the records to verify the refund available for inspection by the BOE. The bill specifies that no refund will be payable until the BOE verifies by audit or other means that the amounts are properly due for refund.

The bill requires the BOE to credit the refund of excess tax reimbursement against amounts due and payable from the retailer that paid the tax, amounts paid by a retailer to satisfy liability related to an audit determination, or amounts owed by the customer. The balance will then be refunded to the customer who paid the excess tax reimbursement. The bill requires the retailer to refund the amount of excess tax reimbursement equal to any credit applied to the retailer's liability directly to the customer who paid it. If the retailer does not make the payment to the customer, the credit will be reversed.

The bill defines the following terms:

- "Person that paid the tax" means a single "person" as defined in Section 6005.
- "Customer" means a single "person" as defined by Section 6005.

If enacted, the bill takes effect on January 1, 2016.

**Legislative History:** AB 1412 (as amended May 24, 2013) would have authorized a retailer to make an irrevocable election to assign the right to receive a refund payment of excess tax reimbursement in the amount of \$50,000 or more to a single customer. The bill passed the Assembly Appropriations Committee (17 ayes, 0 noes) and the Assembly (78-0). On July 10, 2013, AB 1412 was amended to prohibit contingency fees that are charged or paid in connection with the election, assignment, or claim for refund relating to an irrevocable election to assign the right to receive a specified refund. The amendments were recommended by the Senate Governance and Finance Committee, which then passed the bill as amended (7 ayes, 0 noes). While the Senate Appropriations Committee passed the measure on consent, the bill stalled on the Senate Floor. On September 6, 2013, Assembly Members Bocanegra and Gatto gutted and amended the bill with provisions related to personal income taxation.

In 2014, AB 43 (Bocanegra), which was identical to AB 1412, as amended May 24, 2013, passed off the Assembly Floor and out of the Senate Governance and Finance Committee (7 ayes, 0 noes). As amended August 5, 2014, AB 43 permitted a retailer to assign the right to file a claim for excess tax reimbursement in the amount of \$50,000 or more to the customer, and not simply the right to receive refund payment. These amendments increased BOE's administrative costs considerably and the bill was held in the Senate Appropriations Committee.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

## Commentary:

1. **The August 18, 2015 amendments** eliminate the requirement that a retailer make an irrevocable assignment of the right to file a claim for refund to the customer in order for the customer to seek a refund directly from the BOE. Instead, customers can file a claim for refund directly with the BOE. **The June 2, 2015 amendments** reduced the individual refund threshold from \$50,000 to \$1,000. **The April 21, 2015 amendments** were BOE-suggested technical amendments to clarify that a “person that paid the tax” (i.e., the retailer) and a “customer” both mean a single “person” as defined by Section 6005.
2. **Eliminating the assignment process impacts the BOE’s workload.** The assignment process provided a clear record indicating that the customer filed a claim for refund. Retailers making an assignment would have had record that their customer filed a claim for refund. The retailer would also have certified that they had not previously claimed a refund for taxes and would not claim a refund for those taxes in the future. With no assignment process, BOE staff must notify the retailer that the customer has filed a refund.

To process the customer’s refund, the customer must provide the retailer’s name, address, and seller’s permit number. However, BOE staff anticipates receiving refunds in which the customer has either not obtained such information or in which information is incorrect. This will result in additional processing time to contact the customer to request the information. In situations when the customer provides partial information, staff anticipates processing time to locate the retailer through its computer system.

In addition, under the assignment the retailer served as a gatekeeper to help identify invalid refund claims, such as refunds not meeting the \$1,000 threshold or untimely refunds that have expired under the statute of limitations. Because of the retailer’s knowledge of sales tax law, the retailer would have helped to weed out otherwise invalid refund claims. Staff anticipates customers filing refunds regardless of whether they meet the specified criteria. This will increase the BOE’s workload because staff will still have to acknowledge and review the claim and notify the customer that the claim has been rejected.

3. **Both the retailer and customer could appropriately file a claim for refund.** This creates a conflict if a refund claim is filed by both the retailer and the customer. For example, a customer unaware that their purchases of medical devices qualify as an exempt prescription medicine fails to issue an exemption certificate to the retailer and pays sales tax reimbursement on their purchases. Subsequently, the customer files a claim for refund with the BOE. On or about the same period, the retailer is undergoing an audit and finds that it has collected excess tax reimbursement on their sales of medical devices. The retailer files a claim for refund to refund the excess tax reimbursement to multiple customers. The retailer also has unreported taxable sales of medical supplies. Rather than have BOE auditor’s review documentation for each customer’s refund, the retailer prefers to incorporate refunds into one claim within the audit and issue individual payments to its customers. The customer does not wish to wait for the retailer’s audit to be completed. Would the customer or the retailer be entitled to the refund? The language is not clear.
4. **Reducing the threshold from \$50,000 to \$1,000 has a significant impact on BOE’s workload.** Under current law, the retailer is the only person who may file a claim for refund of sales tax. The purchaser must seek a refund of sales tax paid to a retailer directly from the retailer. The current method eliminates problems with both the purchaser and retailer claiming the refund on the same transaction and provides a single point for refund claims. The BOE’s computer system, procedures, processes, forms, etc., are designed for and focused on the retailer.

Lowering the threshold to \$1,000 will likely generate thousands of refund assignments for BOE staff to process. To process a refund, staff must verify that the excess sales tax reimbursement was paid to the BOE. If the retailer did not pay the tax to the BOE, no refund can be made to the purchaser. In addition, BOE staff must complete certain tasks such as adjusting the retailer’s return,

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deallocating the local taxes, entering and verifying purchaser information, and making offsets to prevent duplicative or erroneous refunds.

**5. Effect of the bill.** To implement this bill, the BOE's processes would be as follows:

- BOE staff would develop a new claim for refund form.
- BOE staff would review each refund claim to determine whether it is valid (i.e., claim filed within statute of limitations, claim meets the \$1,000 in tax threshold). Invalid refund claims would be rejected.
- BOE audit staff would verify the retailer's information on the refund form. In cases where the customer fails to provide correct permit information for the retailer, BOE staff would have to search its computer system to identify the retailer and contact the customer to obtain the information if the retailer cannot be located.
- BOE auditor would request the necessary documentation from the customer to determine that it paid sales tax reimbursement. But in order to verify that the tax was paid to BOE and that the items sold were non-taxable, staff would still contact the retailer to obtain the necessary documentation (sales journal pages, sales tax working papers, returns, and possibly sales invoice information). The auditor would also review the retailer's records to ensure that a credit for the excess tax reimbursement was not provided by the retailer to the customer on a subsequent transaction. Large volumes of records may require a BOE auditor to conduct the examination at the retailer's place of business. This could result in delays to obtain documentation and/or schedule an appointment to visit the retailer's place of business.
- Audit staff would verify that neither the retailer nor the customer have an outstanding liability to the BOE against which to credit the excess amount prior to issuing a refund. Staff would examine the books and records of the retailer, to avoid issuing a refund while the retailer has outstanding liabilities.
- Audit staff would amend the retailer's return or returns to create the refund then transfer the refund amount to the customer's account. For customers that do not hold a permit with the BOE, a special (arbitrary) account would have to be created.
- A database would be developed and maintained by the audit staff. In addition to the customer and retailer's information, each transaction (invoice) must be entered into the database to keep track of who has received a refund for that specific transaction.

**6. Potential issues.** A number of issues can arise when the customer files a claim for refund instead of the retailer.

- **Statute of limitations.** The customer may not realize that a purchase transaction is outside the statute of limitations for issuing a refund (generally three years from the due date of the return for which the overpayment was made).
- **Appeal rights.** The customer must file a separate appeal for each vendor/retailer. Under current law, if the BOE denies a retailer's claim for refund (which can include multiple customers), the retailer files one appeal encompassing the multiple transactions.
- **Threshold.** BOE audit staff anticipates issues related to the calculation of the \$1,000 threshold. For example, if a large farmer makes five purchases of farm equipment paying \$200 in tax on each purchase over a two-year period, and one purchase is outside the statute of limitations, then the farmer will not meet the \$1,000 threshold.

If the tax amount to be refunded is less than a \$1,000, the customer has no right to file and receive a refund. Accordingly, the refund claim would be rejected by staff. For example, if the customer files a refund which states the amount of the claim is "\$1,000 or more in tax," and upon review the auditor determines that the amount to be refunded is only \$950.00, the refund will be rejected. The customer would not meet the criteria for filing a sales tax refund and thus must seek a refund of sales tax from the retailer.

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- **Record keeping and access.** Some customers may not hold a permit with the BOE. If the customer does not have the documentation for BOE to validate and approve a refund, the BOE must inspect the retailer's records. Thus, the retailer still must make all the necessary records available for audit as needed, as these records will not be in the customer's possession. This could result in significant delays to schedule the audit or investigation. (National retailers often are audited by many different states. Scheduling audit appointments may take months to coordinate with other audit requests of that retailer.)

Some customers may not hold a permit with the BOE. With the reduced (\$1,000) threshold, it seems likely that many, if not most, claimants will not have permit numbers in the BOE system. BOE staff will need to assign each claimant a special (arbitrary) account number, which will create a whole new category of people that need to be tracked in the BOE's system.

- **Workload increase.** If a customer files refund claims involving multiple vendors, further complications may occur. The process could dramatically increase BOE audit staff workload. Under current law, if a single retailer is entitled to a refund relating to multiple customers who paid \$1,000 or more in tax reimbursement, an auditor conducts a single examination of the retailer's records, and then makes one payment to the retailer. Under this bill, staff would conduct a separate examination of each customer, as well as an examination of the single retailer's records. Additionally, in the case where a customer has filed a claim for refund of \$1,000 or more from more than one vendor, the auditor would issue a separate audit report or field investigation report for each retailer. Separate reporting is necessary because BOE must amend each retailer's return or returns.
  - **Duplication.** A customer filing a refund claim directly with the BOE creates the possibility of issuing duplicate tax refunds. A database to track refunds would be required.
  - **Right to a refund is contingent upon a retailer making the books and records available.** What if the retailer resists or refuses to cooperate? What if the retailer is no longer in business? How to address these issues is not readily clear. Additionally, staff anticipates the tendency to file fraudulent claims when the retailer is no longer in business and staff cannot verify the refund. BOE staff would expect these situations to increase administrative costs. However, by what amount is difficult to determine.
7. **A single customer must file separate refund claims for each (single) retailer.** The bill does not authorize a customer to file a claim for refund encompassing excess tax reimbursement that was collected and remitted by multiple retailers. Instead, it would require separate refund claims meeting the threshold. The bill also does not authorize a customer to aggregate the excess tax reimbursement paid to multiple retailers to reach the \$1,000 threshold. Instead, a refund claim may only be made if a single retailer collected from the customer and remitted to the BOE \$1,000 or greater in excess tax reimbursement. In addition, a single customer means a single person under the Sales and Use Tax Law. Under the Sales and Use Tax Law, a subsidiary is a separate entity/person from its parent. This means that neither the parent company nor its subsidiary can aggregate the subsidiaries' refund claims to reach the \$1,000 threshold.
  8. **Deallocation of local sales taxes and district taxes.** To process a refund claim, BOE would deallocate the Bradley-Burns local sales taxes and any applicable transactions (sales) and use taxes (also known as district taxes) reported and paid by the retailer. The BOE would determine which local jurisdiction was allocated the local sales tax and/or district tax revenue. This information may not be apparent from an invoice or sales receipt. Deallocating the tax may require examination of the retailer's local tax schedules or other schedules and/or working papers used by the retailer to report and allocate its local and district taxes to the BOE. Without verification, revenue may be misallocated.
  9. **Administrative start-up cost funding is essential.** The bill's operative date is January 1, 2016. As a result, the BOE must begin to implement the bill in fiscal year 2015-16. However, the BOE's 2015-16 budget does not include funding to implement the bill. Consequently, the BOE requires either an adequate appropriation to cover administrative implementation costs or a delayed operative date.

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If an appropriation is not granted, BOE staff will submit a budget change proposal through the normal budget process for fiscal year 2016-17. Staff would need at least 90 days to perform the necessary programming to track and monitor the refund assignments. The earliest operative date would be October 1, 2016. BOE staff is willing to work with the author's office to address this issue.

**10. Suggested technical amendments.** The \$1,000 threshold in the bill is intended to apply to tax only. Subdivision (b)(1)(A) states that "The entire amount represents excess tax reimbursement." Subdivision (b)(1)(B) states that "The amount to be refunded is one thousand dollars (\$1,000) or more." To eliminate any ambiguity that the refund amount (threshold) represents tax only, BOE staff recommends the following amendment:

- Paragraph (1)(B) of subdivision (b), add "in tax" after "(\$1,000) or more"

In addition, the second amendment is to add "or paid" to make the language in the first sentence of paragraph (3) of subdivision (b) consistent with itself. The first part of the sentence reads, "The excess amount collected *or paid*. . ." Accordingly, staff recommends the following amendment:

- Paragraph (3) of subdivision (b), add "or paid" after "excess tax reimbursement was collected" to the end of the first sentence

**Administrative Costs:** Costs to implement this bill would be significant. BOE staff must develop and maintain a database to carefully track refunds in order to avoid duplicative tax refunds and other issues. Additional workload includes creating a new assignment form, modifying existing forms and manuals, developing a special publication, acknowledging refunds, determining refund eligibility, verifying and processing refunds, handling refund claims which are partially or fully denied, preparing guidelines for staff, and answering questions from retailers and customers. In addition, the State Controller's Office charges \$0.71 per warrant, the number of which is likely to increase under this bill.

These costs are estimated to be \$5.4 million for Fiscal Year (FY) 2015-16, rising to \$6.7 million for FY 2016-17, and \$6.6 million, ongoing thereafter.

**Revenue Impact:** Actual revenue impact is indeterminable. However, to the extent that additional claims involving excess sales tax reimbursement would be filed, this could result in a significant state and local revenue loss.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.